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Supreme Court of the United States

OCTOBER TERM, 1940

715
No. _____

ARKANSAS CORPORATION COMMISSION, _____ *Petitioner,*

v.

**GUY A. THOMPSON AS TRUSTEE OF MISSOURI
PACIFIC RAILROAD COMPANY, DEBTOR _____** *Respondent.*

**SUPPLEMENTAL BRIEF IN SUPPORT OF THE
PETITION FOR WRIT OF CERTIORARI**

JACK HOLT,

*Attorney General of the
State of Arkansas,*

Counsel for Petitioner.

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**MOTION FOR LEAVE TO FILE SUPPLEMENTAL
BRIEF IN SUPPORT OF PETITION FOR
WRIT OF CERTIORARI.**

Your petitioner respectfully asks leave to file a supplemental brief amplifying one of the points in the original brief, and citing additional authorities.

Respectfully submitted,

JACK HOLT,

Attorney General of Arkansas,

Counsel for Petitioner.

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SUPPLEMENTAL BRIEF IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

The opinion of the Circuit Court of Appeals appears
on page 45 of the record, and is reported in _____
Fed. (2d) _____.

The date of the decree to be reviewed is January 3,
1941.

The statutory provision which is believed to sustain the
jurisdiction of this court is section 240 of the Judicial Code
(28 U.S.C.A. sec. 347).

A concise statement of the case appears in the petition
for writ of certiorari, and is hereby adopted and made a
part of this brief.

The sole purpose of this brief is to amplify one of the
topics of the brief heretofore filed for the petitioner, and to
cite additional cases.

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POINT AND AUTHORITIES RELIED ON

A.

Section 64 of the general bankruptcy act is not a part of section 77, the railroad reorganization amendment.

Boteler v. Ingels, 308 U.S. 61,

Brannon in re, 62 Fed. (2d) 959, (C.C.A. 5),

Cardwell in re, 52 Fed. (2d) 158,

Charles Nelson Co. in re, 27 Fed. Supp. 653,

Clayton Magazines in re, 77 Fed. (2d) 852, (C.C.A. 2),

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City of Richmond v. Bird, 249 U.S. 174,

City of Springfield v. Hotel Charles, 84 Fed. (2d) 589, (C.C.A. 1),

Henderson County v. Wilkins, 43 Fed. (2d) 670 (C.C.A. 4),

Hennepin County v. Savage Factories, 83 Fed. (2d) 453, (C.C.A. 8),

Hotel Martin Company in re, 114 Fed. (2d) 43, (C.C.A. 2),

Humeston in re, 83 Fed. (2d) 187 (C.C.A. 2),

Lang Body Company in re, 92 Fed. (2d) 338 (C.C.A. 6),

Lowden v. N. W. National Bank & Trust Company, 298 U.S. 160, 56 S. Ct. 696,

MacGregor v. Johnson-Cowdin, 39 Fed. (2d) 574
(C.C.A. 2),

New York O. & W. Ry. Co. in re, 25 Fed. Supp. 709,

168 Adams Building Corporation in re, 105 Fed. (2d)
704, (C.C.A. 7),

Palmer v. Commonwealth of Massachusetts, 308 U.S.
79, 60 S. Ct. 34,

Robertson v. Goree, 29 Fed. (2d) 261 (C.C.A. 5),

Simcox in re, 243 Fed. 479,

Thermodyne Radio Corporation in re, 26 Fed. (2d)
716,

Thompson v. Louisiana, 98 Fed. (2d) 108 (C.C.A. 8),

U. S. Fidelity & Guaranty Co. v. Sweeney, 80 Fed. 235
(C.C.A. 8),

11 U.S.C.A. sec. 104 (a), Pocket page 18,

11 U.S.C.A. sec. 205 (1).

ARGUMENT

I.

Section 64a of the general bankruptcy act is not a part of section 77, the railroad reorganization amendment.

The Circuit Court of Appeals held that section 64a was a part of section 77. The court seemed to be under the impression that the power of a bankruptcy court to determine the validity of tax claims in a railroad reorganization proceeding stemmed entirely from section 64a, and if this section were not a part of section 77 the court would not possess the power.

The question is one of great public importance in view of the many railroad reorganization proceedings that are now pending. It is equally important in its relation to the exercise of state taxing power. It ought to be authoratively settled.

Section 64a as amended by the act of June 22, 1938, known as the Chandler act, reads in part as follows:

"The debts to have priority, in advance of payment of dividends to creditors, and to be paid in full out of the bankrupt's estate, and the order of payment, shall be . . . (4) taxes legally due and owing by the bankrupt to the United States or any state or any subdivision thereof; *provided* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; *And provided further*, That in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court."

Subsection 1 of section 77 provides as follows:

"In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

11 U.S.C.A. sec. 205 (1).

Whether or not section 64a is a part of section 77 depends on whether 64a is "consistent with the provisions" of section 77.

An analysis of section 64a shows that it is wholly inconsistent with section 77.

The purpose of the general bankruptcy act, of which section 64a is a part, is to bring about a sale of all the assets of the bankrupt and a distribution of the proceeds among the creditors. The purpose of section 77 is to avoid a sale of any of the property of the debtor railroad company, and to guarantee the continuance of the operation of the railroad for the benefit of the public.

Section 64a is the priority section of the bankruptcy act. Its sole purpose is to give priority to certain classes of unsecured debts over the payment of dividends to general creditors and to prescribe the order in which the several classes of debts are to be paid.

"Section 64, known as the priority section of the Bankruptcy Act, relates exclusively to the subject of the rights of priority of payment arising among those whose claims would, in the absence of such section,

stand on terms of equality before the law as general unsecured creditors."

In Re Cardwell, 52 Fed. (2d) 158.

See also:

In Re Brannon, 62 Fed. (2d) 959, (C.C.A. 5)

Section 77 does not contemplate the payment of debts at all except as payment may be provided for in a reorganization plan. The payment of debts as in ordinary bankruptcy is foreign to the very genius of its purpose.

The taxes referred to in subdivision (4) of section 64a are "taxes due and owing by the bankrupt," that is, taxes that accrued before the institution of bankruptcy proceedings. Such taxes, if they are not a lien on the property of the bankrupt, are classified in the fourth class by section 64a and are to be paid ahead of dividends to general creditors.

Though taxes due and owing by the bankrupt are given the priority of the fourth class by section 64a, they do not take precedence in the order of their payment over liens and encumbrances.

"Section 64a of the Bankruptcy Act, in directing payment of taxes before dividends to creditors, means general creditors. When by the local law a lien for a private debt is superior to a claim for taxes, its status is preserved by section 67d."

City of Richmond v. Bird, 249 U.S. 174.

See also:

U. S. Fidelity & Guaranty Co. v. Sweeney, 80 Fed. (2d) 235, (C.C.A. 8)

In Re Brannon, 62 Fed. (2d) 959, (C.C.A. 5)

Taxes are not mentioned in section 77, but taxes due and owing by the bankrupt would be claims in a railroad reorganization proceeding. If they were not a lien on the property of the debtor they would be classified as unsecured claims, but the classification would be for voting purposes only.

Taxes "due and owing by the bankrupt" which are a lien on the property of the bankrupt do not fall within the fourth class under section 64a. The lien is not displaced by supervening bankruptcy. But the fourth subdivision of section 64a provides that "no order shall be made for the payment of the tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court." It is with reference to taxes due and owing by the bankrupt and especially with reference to such taxes which are liens on the property of the bankrupt that subdivision (4) prescribes: "*Provided Further, That (2) in case any question arises as to the amount or legality of any taxes such question shall be heard and determined by the court.*"

If a tax due and owing by the bankrupt is a lien on property of the bankrupt section 64a requires the court to determine whether it will take possession of the property *cum onere* the tax or reject the property. If it takes possession, it must order the trustee to pay the tax even though the amount of the tax exceeds the value of the property of the estate.

Hennepin County v. Savage Factories, 83 Fed. (2d) 453, (C.C.A. 8)

In Re Brannon, 62 Fed. (2d) 959, (C.C.A. 5)

City of Richmond v. Bird, 249 U.S. 174.

The court cannot refuse to take possession of property belonging to the bankrupt under section 77 because it is burdened with taxes. A supposititious case will illustrate the point:

If a branch line of a railroad is so worthless that it does not pay operating expenses, and its value to the railroad company is less than the amount of accumulated tax liens against it, the possession of the branch line would nevertheless immediately vest in the bankruptcy court on the approval of the petition in a reorganization proceeding under section 77, and the court would be powerless to dispossess itself of it. The court would have no authority under section 77, as it would have in ordinary bankruptcy, under section 64, to order the trustee not to take possession of the branch line as a part of the debtor's estate. The branch line could only be abandoned, under section 77, pursuant to proceedings before the Interstate Commerce Commission under the Transportation Act.

Palmer v. Commonwealth of Massachusetts, 308 U.S. 79; 60 Sup. Ct. 34.

The taxes which fall in the fourth class under section 64a are taxes which are to be paid out of the proceeds of a sale of the assets of the bankrupt estate.

"Section 64a gives the rule for paying out the money arising from the bankrupt's property which remains for general distribution after all special liens and encumbrances have been dealt with."

In Re Brannon, 62 Fed. (2d) 959, (C.C.A. 5)

There is never any money "arising from the bankrupt's property which remains for general distribution after all special liens and encumbrances have been dealt

with," under section 77. That section does not authorize a sale of the debtor's property for the purpose of paying its debts. The whole purpose of section 77 is to prevent a sale of the debtor's property and to keep it intact so as to guarantee its continued operation.

Section 64a is a priority section and is only applicable to liquidation. Liquidation can never occur under section 77.

Liquidation may occur under section 77B, 11 U.S.C.A. sec. 207, and that section appropriately provides that if a reorganization proceeding is converted into a liquidation proceeding section 64a shall become operative.

Clause (8) of subsection (c) of section 77B provides that if the reorganization plan is not confirmed the judge may "direct the estate to be liquidated." Clause (5) of subsection (k) provides that if an order of liquidation is entered "debts shall be entitled to priority as provided in section 104 (section 64a) of this title."

No such provisions are found in section 77, and there could be no occasion under that section for according priorities to certain classes of debts over the payment of dividends to general creditors.

The legal consistency which constitutes the test of the applicability of any section of the bankruptcy act to section 77 is not a strained or forced reconciliation of the particular section with section 77, but is a consistency with the general scope and purpose of section 77 and a logical complement in the accomplishment of that purpose. The special object of section 77, therefore, must be kept in mind. Its objective is altogether different from the objective of the bankruptcy act.

"A proceeding of reorganization is not a bankruptcy, though an amendment to the bankruptcy act creates and regulates the remedy."

Lowden v. N. W. National Bank & Trust Co., 298
U.S. 160,

S. C. 56 Sup. Ct. 696.

Thus, applying the consistency test, it was held that section 68a of the bankruptcy act, 11 U.S.C.A. sec. 108 (a) which provides that "in all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed and paid," was wholly inconsistent with the purpose of section 77 and was therefore not a part of that section.

Lowden v. Northwestern Nat. Bank & Trust Co.,
84 Fed. (2d) 847. (C.C.A. 8)

We have been testing the consistency of section 64a with section 77 by showing that the priorities prescribed by section 64a which are to be accorded certain enumerated claims for payment out of the proceeds of the property of the estate ahead of dividends to general creditors, and especially the classification of taxes due and owing by the bankrupt, do not fit into the picture of section 77, and are at variance with its purpose.

Taxes which accrue against the property of the debtor in the possession of the trustee during the pendency of ordinary bankruptcy or of railroad reorganization proceedings are a part of the expense of administering the estate. They are not classifiable under section 64a in ordinary bankruptcy, and they are not classifiable as claims against the debtor's estate in reorganization proceedings. They are

expenses incurred by the court itself in the management of the estate, and are payable ahead of all other claims, like the compensation to the trustee and the expense of preserving and operating the estate.

Hennepin County v. Savage, 83 Fed. (2d) 453,
(C.C.A. 8)

Thompson v. Louisiana, 98 Fed. (2d) 108
(C.C.A. 8)

Boteler v. Ingels, 308 U.S. 61,

In Re Charles Nelson Company, 27 Fed. Supp. 673,

Robertson v. Goree, 29 Fed. (2d) 261 (C.C.A. 5)

MacGregor v. Johnson-Cowdin, 39 Fed. (2d) 574,
(C.C.A. 2)

In Re Humeston, 83 Fed. 187 (C.C.A. 2)

The tax involved in this litigation is an ad valorem tax imposed by the State of Arkansas on the physical properties of the debtor within its borders. Under the laws of the state the tax is a first-lien on such properties. The tax was levied during the pendency of the reorganization proceedings and is therefore a part of the expense of administration. It does not fall within the scope or purview of section 64a.

The whole purpose of 64a is to accord propriety to certain claims in the order named ahead of dividends to general creditors. The section is entitled "Debts Which Have Priority." It begins as follows:

"The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full

out of bankrupt estates, and the order of payment, shall be."

11 U.S.C.A. sec. 104 (a)

The Circuit Court of Appeals apparently held that the district court obtained jurisdiction of the tax claim filed by the state under 64a. This is wholly incorrect. It derived its jurisdiction of the entire reorganization proceeding from section 77, and it has inherent jurisdiction, like any other court, to pass on and allow the expense of administration of an estate in its custody. The application of 64a to the tax in question would lead to utter confusion. For illustration, if the tax is governed by section 64a it would have to be classified as a fourth class claim under that section. And while it would have to be paid ahead of dividends to general creditors (and there are no dividends to general creditors under section 77) it might be subordinated to or put on a parity with lien claims. This seems to be what the Circuit Court of Appeals had in mind, for it said:

"It is vitally necessary that the bankruptcy court to which the reorganization of the railroad debtor herein has been confided by section 77 of the Act shall be empowered to determine the validity and amount of all liens against the railroad property and to marshal them in order to accomplish the purpose of the reorganization proceedings. Section 64a confers such power in respect to taxes."

Section 77 does not contemplate or provide for a marshalling of liens in a reorganization proceeding. The court is not concerned with that subject at all. Everything of that character has to be worked out through the reorganization plan, subject to the approval of the creditors, the stockholders, the Interstate Commerce Commission and the court.

On account of the conflicting opinions of district courts and of Circuit Courts of Appeals with reference to the construction of section 64a, and the power of a bankruptcy court in determining the legality and amount of taxes under that section, a holding that section 64a is a part of section 77 would introduce utter confusion in railroad reorganization proceedings.

It has been held that the decisions of this court to the effect that a taxpayer must exhaust the administrative remedy provided by law for relief against an excessive and discriminatory assessment before he can resort to the courts are not applicable to bankruptcy proceedings, and that a trustee in bankruptcy is not required to exhaust the administrative remedy. *In re Thermidyne Radio Corporation*, 26 Fed. (2d) 716. It has been held, on the contrary, that a trustee in bankruptcy must exhaust the administrative remedy. *City of Springfield v. Hotel Charles*, 84 Fed. (2d) 589. (C.C.A. 1). It has been held that the action of the bankruptcy court "is not a review of the action of the taxing authorities," but is "a determination under the statute of the amount which should be paid on the claim for taxes." *Henderson County v. Wilkins*, 43 Fed. (2d) 670, (C.C.A. 4). It has been held, on the contrary, that the law presumes that the assessment made by the taxing authorities is correct, and that the burden is on the trustee in bankruptcy "of showing that they transgressed all reasonable limits, in derogation of the trustee's rights in the property." *In re Lang Body Company*, 92 Fed. (2d) 338. (C.C.A. 6) Certiorari denied, *Hipp, Trustee, v. Boyle, Treasurer*, 303 U.S. 637, 58 Sup. Ct. 522. It has been held that it is "the power and duty of this court (the bankruptcy court) to reassess the tax in case objection is made, regardless of its

original assessment by the proper state authority," and that the reassessment "must be upon evidence in this court going directly to the merits." *In re Simcox*, 243 Fed. 479. It has been held, on the contrary, that "taxes—except when challenged for illegality because of a want of power to levy, or in respect of a failure to pursue indispensable steps of procedure in assessing or levying—are incontestible." *In re Gould Manufacturing Company*, 11 Fed. Supp. 644. It has been held that the "court in a bankruptcy proceeding has jurisdiction to re-examine and revise a state tax and allow it for only the amount which appears to be justly due." *In re New York, O. & W. Ry. Co.*, 25 Fed. Supp. 709. It has been held, on the contrary, that "the court must first pass on the validity of the tax before it can decide whether to allow or disallow the claim," and that "the court must determine the validity of the tax in accord with the laws of the taxing sovereign." *In re 168 Adams Building Corporation*, 105 Fed. (2d) 704. (C.C.A. 7) It has been held that where a state statute provides for a suit in the state court to recover a refund of an illegal tax, a trustee in bankruptcy is not required to pursue that remedy. *In re Clayton Magazines*, 77 Fed. (2d) 852. (C.C.A. 2) And it has been held, on the contrary, that where a state statute required a suit to test the validity of an assessment to be brought in a state court within thirty days, the assessment was conclusive against a trustee in bankruptcy who had failed to bring such a suit. *In re Hotel Martin Company*, 114 Fed. (2d) 43. (C.C.A. 2)

Many other conflicts appear in the decisions with reference to an alleged special and peculiar power of a court of bankruptcy under the aegis of section 64a. The confusion arising out of these conflicts, and the consequent effect of such confusion on the taxing systems of the state, make it

extremely important that this court should determine whether or not section 64a is a part of section 77.

Respectfully submitted,

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